



CITY OF SAN JOSÉ, CALIFORNIA

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GERALD A. SILVA
City Auditor

May 4, 1987

Honorable Mayor and Members
of the San Jose City Council
801 North First Street
San Jose, CA 95110

Transmitted herewith is my response to Councilmembers Hammer and Lewis' April 7, 1987, and Councilmember Hammer's April 14, 1987, request for information regarding Fine Arts Funding.

I want to thank the following persons for their contribution to this process: Rene Bulan (City Auditor's Office), Susan George (Deputy City Manager), John Popovich (Director of Cultural Activities), Jim McBride (Convention & Cultural Facilities Department), John Pasto and Lee Vinocour (City Attorney's Office), and Brooke Myhre and Karin Lohrey (OMB).

I will present my report to the City Council at its May 5, 1987, meeting.

Respectfully submitted,

Gerald A. Silva
City Auditor

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GS:mlt

cc: Gerald Newfarmer, City Manager
Joan Gallo, City Attorney
Rene Bulan, City Auditor's Office
Susan George, Deputy City Manager
John Popovich, Director of Cultural Activities
Jim McBride, Convention & Cultural Facilities Department
John Pasto, City Attorney's Office
Lee Vinocour, City Attorney's Office
Brooke Myhre, Office of Management and Budget
Karin Lohrey, Office of Management and Budget

EXECUTIVE SUMMARY

The Transient Occupancy Tax Special (TOT) Fund was established in 1981 to provide a continuing funding source for the Convention and Visitors Bureau, Cultural Groups, and the Convention and Cultural Facilities Department. In 1982, the City Council added the Fine Arts Division of the Convention and Cultural Department as a TOT fund recipient. The City Council also prescribed, by Ordinance, how the TOT Fund was to be allocated between the various recipients.

The purposes of our review were to 1) compare how the TOT Fund should have been allocated to the various recipients to actual allocations and 2) answer specific City Council member questions. The results of our review are as follows:

- By using a full accrual method of accounting for budget purposes, there should be sufficient reserves in the TOT Fund as of June 30, 1987, to:
 - o Maintain funding for cultural groups in 1987-88 at the 1986-87 level or \$766,635;

- o Maintain funding for the Convention and Visitors Bureau, Fine Arts Division and Convention & Cultural Facilities Department in 1987-88 at 1986-87 levels or \$824,000, \$181,343, and \$1,261,622, respectively;
 - o Return to the General Fund the \$262,000 and \$97,500 (\$359,500) that was transferred to the TOT Fund in 1985-86 and 1986-87, respectively;
 - o Leave \$142,625 in the TOT Fund as 1) a reserve against future revenue erosions or 2) a discretionary reservoir for City Council allocations to the four recipient entities.
- While the Administration did attempt to allocate the TOT Fund in accordance with the Ordinance prescribed formula, differences do exist between the Ordinance prescribed and actual allocations for every year. These differences exist primarily because 1) the budget, of necessity, is based on estimated receipts, whereas, the Ordinance implies actual receipts, 2) no attempt was made to reallocate actual revenues in

excess of estimated revenues in subsequent budget years, and 3) no attempt was made to allocate interest earnings that were accruing in the TOT Fund.

- The Ordinance-prescribed 12% cap restriction was only applied in 1983-84 and 1984-85. Had the 12% cap not been applied, Cultural Groups would have received an additional \$67,102 in 1983-84 and \$102,115 in 1984-85. The Administration used estimated revenues when it determines if the 12% cap applied. The use of estimates would produce results somewhat different than the figures cited here for 1983-84 and 1984-85.
- From 1982-83 through 1986-87, the Culture Groups have contributed a cumulative \$667,164 to support the Fine Arts office staff.* In 1987-88, the Cultural Groups

*Assuming the Cultural Groups contributed one-half of the \$91,000 that was budgeted for the Fine Arts Division in 1982-83.

are estimated to contribute \$181,343 to support the Fine Arts Division. This support is in the form of permanent reductions to the Cultural Groups' revenue allocation basis that have occurred since 1982-83.

- The current TOT Ordinance does not provide any certainty regarding funding for the recipient entities.

RECOMMENDATIONS

We recommend the following:

1. The Administration use a full accrual method of accounting for the TOT Fund for budget purposes.
2. The City Council amend Section 4.72.060 of the City Code to provide that the TOT Fund allocations to the Convention and Visitors Bureau, Cultural Groups, Fine Arts Division and Convention and Cultural Facilities Department be based upon estimated

revenues for the budget year. Further, revenues for the purpose of this Code Section should be defined in accordance with Generally Accepted Accounting Principles.

A REVIEW OF THE TRANSIENT
OCCUPANCY TAX SPECIAL FUND

In order to respond to Councilmembers Hammer and Lewis' requests for information, we researched the City Code as it pertains to the TOT. Next, we calculated how the TOT Fund should have been allocated between the Convention and Visitors Bureau, Cultural Groups, Fine Arts Division and Convention and Cultural Facilities Department for the years 1981-82 through 1987-88. Our Code interpretations were reviewed with the City Attorney's Office. *TABLE I* is a summary of that process. It should be noted that the following assumptions were made when preparing *TABLE I*:

- Revenue increases or decreases were allocated on the basis of 25%, 25% and 50% between the Convention and Visitors Bureau, the Cultural Groups and Fine Arts Division, and the Convention and Cultural Facilities Department in 1981-82, 1982-83, and 1985-86 through 1987-88.
- Revenue increases were allocated to the Convention and Visitors Bureau and the Cultural Groups and Fine Arts Division, based on the 12% cap Ordinance provision in

1983-84 and 1984-85. The 12% cap 1) increased the TOT Fund allocation to the Convention and Cultural Facilities Department by \$183,491 in 1983-84 and \$200,633 in 1984-85, and 2) reduced the allocation to the Convention and Visitors Bureau and Cultural Groups accordingly.

- It was assumed that in 1982-83 the Convention and Visitors Bureau and the Cultural Groups each provided \$45,500 to support the Fine Arts Division. It should be noted that this assumption is based upon a discussion with the Director of Cultural Activities. There is no record of City Council intent regarding this matter. It should also be noted that the revenue allocation basis for both the Convention and Visitors Bureau and the Cultural Groups was permanently reduced by the amount of this support. In addition, the revenue allocation basis for the Cultural Groups was further permanently reduced by subsequent contributions to the Fine Arts Division in 1983-84 through 1986-87.

- In 1984-85, the revenue allocation basis for the Convention and Visitors Bureau, Cultural Groups and the Convention and Cultural Facilities Department was reduced \$69,500, \$69,500 and \$139,000, respectively as their prorata share of the 1983-84 investment loss.

After completing *TABLE I*, we proceeded to compare our calculated TOT allocations in *TABLE I* to budget allocations in 1981-82 through 1986-87. This comparison is summarized in *TABLE II*. The following observations are pertinent relative to *TABLE II*:

- Differences exist every year between calculated and budgeted allocations. These differences are primarily the result of 1) the estimation factor that is inherent in any budgeting process, 2) underestimated revenues not being added to subsequent years' allocations for budget purposes and 3) accrued revenues and earned interest not being considered for budget purposes.
- In 1983-84, a special allocation was made to the Convention and Cultural Facilities Department for roof repairs. OMB considered that \$200,000 as an increase to the Department's revenue allocation basis until 1985-86, when the oversight was corrected.

- In 1985-86, because of expected TOT shortages, the Convention and Cultural Facilities Department returned \$230,000 to the TOT and the General Fund provided a \$262,000 subsidy.
- In 1986-87, again because of expected TOT shortages, the Convention and Cultural Facilities Department and the Convention and Visitors Bureau did not spend \$195,000 and \$97,500, respectively, of their TOT budgeted amounts.

Finally, it should be noted that our calculated cumulative TOT Fund Balances vary greatly from the Administration's. The reason for these differences is that we predicated our calculated TOT allocations on the TOT revenues shown in the City's Audited Financial Statements. That means our revenue figures contain three elements the Administration's does not; actual receipts, interest earnings credited to the TOT Fund, and accrued revenues. As a result, our calculated TOT Fund Balances, which agree with the City's Audited Financial

Statements, are significantly higher than the Administration's. In fact, on Page 14 of *TABLE II* we show the TOT Fund Balance at June 30, 1987, to be \$822,125 as follows:

ESTIMATED COMPOSITION OF FUND BALANCES AT JUNE 30, 1987	BALANCE <DEFICIT>
Loan from General Fund to Cultural Groups	\$ 97,500
Unallocated General Fund Subsidy	262,000
Convention and Visitors Bureau	154,450
Cultural Groups	< 12,963>
Convention and Cultural Facilities Department	<u>321,138</u>
	<u>\$ 822,125</u>

Accordingly, as is shown in the Estimated 1987-88 column of *TABLE II* on Page 14, using a full accrual method of accounting for budget purposes, there should be sufficient reserves in the TOT Fund as of June 30, 1987, to:

- o Maintain funding for Cultural Groups in 1987-88 at the 1986-87 level or \$766,635;

- o Maintain funding for the Convention and Visitors Bureau, Fine Arts Division and Convention and Cultural Facilities Department in 1987-88, at 1986-87 levels or \$824,000, \$181,343, and \$1,261,622, respectively;
- o Return to the General Fund the \$262,000 and \$97,500 (\$359,500) that was transferred to the TOT Fund in 1985-86 and 1986-87, respectively;
- o Leave \$142,625 in the TOT Fund as 1) a reserve against future revenue erosions, or 2) a discretionary reservoir for City Council allocations to the recipient entities.

Finally, it is obvious that the current TOT Ordinance does not provide any certainty regarding funding for the recipient entities. This is a function of the wording of the Ordinance. Specifically, the Ordinance requires the TOT Fund recipients to prepare budgets and allocate funds to competing groups based upon an estimate of next year's TOT receipts. While this practice is not a problem when actual receipts exceed estimated receipts, it does create major problems when the opposite occurs. This is particularly true for the Cultural Groups which must commit funds to competing groups in March of each

year, based upon an estimate of next year's TOT revenues. In our opinion, one solution to this problem would be to amend the TOT Ordinance to provide that TOT Funds are to be allocated to the four recipient entities based upon estimated TOT revenues. Further, revenues should be defined in terms of Generally Accepted Accounting Principles. This practice would provide an assured funding level for the recipient entities in that any shortfall in next year's TOT revenues would have to be made up with either accumulated TOT Fund Balances or General Funds, should the TOT Fund Balance not be sufficient. It should be noted that while this approach appears to expose the General Fund to a certain degree of additional risk, it really is not a marked departure from past practices. For example, the General Fund did subsidize the TOT Fund \$262,000 in 1985-86 and loaned the Cultural Groups \$97,500 in 1986-87, when the Administration thought the TOT Fund was overcommitted.

RECOMMENDATIONS

We recommend the following:

1. The Administration use a full accrual method of accounting for the TOT Fund for budget purposes.

2. The City Council amend Section 4.72.060 of the City Code to provide that TOT Fund allocations to the Convention and Visitors Bureau, Cultural Groups, Fine Arts Division and Convention and Cultural Facilities Department be based upon estimated revenues for the budget year. Further, revenues for the purpose of this Code section should be defined in accordance with Generally Accepted Accounting Principles.

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TABLE I
CALCULATED ORDINANCE PRESCRIBED
TRANSIENT OCCUPANCY TAX ALLOCATIONS
1980-81 THROUGH 1987-88

	Base Year 1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	Estimated 1986-87	Estimated 1987-88
REVENUES	\$1,581,000*	\$1,883,825*	\$2,078,463*	\$2,710,289*	\$3,514,180*	\$3,148,760*	\$2,842,858	\$2,713,000
DISTRIBUTION PER ORDINANCE:								
Convention & Visitors Bureau (A.1)								
Base Allocation	683,455	683,455	759,161	762,321	853,799	886,755	864,900	788,425
Add Maximum Entitlement: 12% of Prior Year's Allocation or 25% of Current Year's Increase (or Decrease)		75,706	48,660	91,478	102,456	<21,855>	<76,475>	<32,464>
Total Allocation		\$ 759,161	\$ 807,821	\$ 853,799	\$ 956,255	\$ 864,900	\$ 788,425	\$ 755,961
Less Allocation to Cultural Groups for Fine Arts Division			<45,500>**					
Less Adjustment for Investment Loss					<69,500>			
Net Allocation	\$ 683,455	\$ 759,161	\$ 762,321	\$ 853,799	\$ 886,755	\$ 864,400	\$ 788,425	\$ 755,961

* Per Audited Financial Statements

** Assumes equal distribution of \$91,000 for Fine Arts Division between
Convention & Visitors Bureau and Cultural Groups

TABLE 1 (CONT)
CALCULATED ORDINANCE PRESCRIBED
TRANSIENT OCCUPANCY TAX ALLOCATIONS
1980-81 THROUGH 1987-88

	Base Year 1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	Estimated 1986-87	Estimated 1987-88
Cultural Groups (A.2.a)								
Base Allocation	679,000	679,000	754,706	757,866	823,810	814,824	777,334	689,494
Add Maximum Entitlement: 12% of Prior Year's Allocation or 25% of Current Year's Increase (or Decrease)		75,706	48,660	90,944	98,857	<21,855>	<76,475>	<32,464>
Total Allocation		\$ 754,706	\$ 803,366	\$ 848,810	\$ 922,667	\$ 792,969	\$ 700,859	\$ 657,030
Add Allocation from Convention and Visitors Bureau			45,500*					
Less Adjustment for Investment Loss					<69,500>			
Less Allocations to Fine Arts Div.			<91,000>	<25,000>	<38,343>	<15,635>	<11,365>	
Net Allocation	\$ 679,000	\$ 754,706	\$ 757,866	\$ 823,810	\$ 814,824	\$ 777,334	\$ 689,494	\$ 657,030
Fine Arts Division (A.2.b)								
Base Allocation			0	91,000	116,000	154,343	169,978	181,343
Allocations from Conv. & Visitors Bureau and Cultural Groups			91,000	25,000	38,343	15,635	11,365	
Total Allocation		\$ 91,000	\$ 116,000	\$ 154,343	\$ 154,343	\$ 169,978	\$ 181,343	\$ 181,343

* Assumes equal distribution of \$91,000 for Fine Arts Division between Convention & Visitors Bureau and Cultural Groups.

TABLE I (CONT)
CALCULATED ORDINANCE PRESCRIBED
TRANSIENT OCCUPANCY TAX ALLOCATIONS
1980-81 THROUGH 1987-88

	Base Year 1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	Estimated 1986-87	Estimated 1987-88
DISTRIBUTION PER ORDINANCE:								
Convention & Cultural Facilities Department (A.3)								
Base Allocation	218,545	218,545	369,958	467,277	916,680	1,380,258	1,336,548	1,183,596
Add 50% of Current Year's Increase (or Decrease)		151,413	97,319			<43,710>	<152,952>	<64,930>
or								
50% of Current Year's Increase Plus Amounts in Excess of the 12% Described Above				499,404	602,578			
Less Adjustment for Investment Loss					<139,000>			
Total Allocation	\$ 218,545	\$ 369,958	\$ 467,277	\$ 916,680	\$1,380,258	\$1,336,548	\$1,183,596	\$1,118,666
TOTAL DISTRIBUTION PER ORDINANCE	\$1,581,000	\$1,883,825	\$2,078,463	\$2,710,289	\$3,514,180	\$3,148,760	\$2,842,858	\$2,713,000
Less Adjustment for Investment Loss					\$ <278,000>			
Total After Adjustment					\$3,236,180			

TABLE II
TRANSIENT OCCUPANCY TAX
COMPARISON OF ORDINANCE PRESCRIBED TO
ACTUAL REVENUE ALLOCATIONS
1980-81 THROUGH 1987-88

	Base Year 1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	Estimated 1986-87	Estimated 1987-88
DISTRIBUTION PER ORDINANCE VS. ACTUAL DISTRIBUTION BASED ON ANNUAL BUDGET AND EXPENDITURES:								
Convention & Visitors Bureau (A.1)								
Per Ordinance	\$ 683,455	\$ 759,161	\$ 762,321	\$ 853,799	\$ 886,755	\$ 864,900	\$ 788,425	\$ 755,961
Less Approved Budget	<683,455>	<723,000>	<764,500>	<769,000>	<846,500>	<958,000>	<824,000>	<824,000>*
Plus Unexpended Budget	0	18,960	7,629	0	0	0	97,500	0
Unused/(Excess) Allocation	\$ 0	\$ 55,121	\$ 5,450	\$ 84,799	\$ 40,255	\$ <93,100>	\$ 61,925	\$ <68,039>
Cultural Groups (A.2.a)								
Per Ordinance	\$ 679,000	\$ 754,706	\$ 757,866	\$ 823,810	\$ 814,824	\$ 777,334	\$ 689,494	\$ 657,030
Less Approved Budget	<679,000>	<719,000>	<735,500>	<770,000>	<816,157>	<912,365>	<766,635>	<766,635>*
Plus Unexpended Budget	0	20,475	25,717	3,376	4,701	34,391		
Unused/(Excess) Allocation	\$ 0	\$ 56,181	\$ 48,083	\$ 57,186	\$ 3,368	\$ <100,640>	\$ <77,141>	\$ <109,605>
Loan from General Fund							97,500	

* Assumes Continuation of 1986-87 Funding Level

TABLE II
TRANSIENT OCCUPANCY TAX
COMPARISON OF ORDINANCE PRESCRIBED TO
ACTUAL REVENUE ALLOCATIONS
1980-81 THROUGH 1987-88

	Base Year 1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	Estimated 1986-87	Estimated 1987-88
Fine Arts Division (A.2.b)								
Per Ordinance			91,000	116,000	154,343	169,978	181,343	181,343
Less Approved Budget			<91,000>	<116,000>	<154,343>	<169,978>	<181,343>	<181,343>*
Convention & Cultural Facilities Department (A.3)								
Per Ordinance	\$ 218,545	\$ 369,958	\$ 467,277	\$ 916,680	\$ 1,380,258	\$ 1,336,548	\$ 1,183,596	\$ 1,118,666
Less Approved Budget	<218,545>	<193,000>	<389,000>	<558,000>	<1,625,000>	<1,532,157>	<1,261,022>	<1,261,022>*
Less Returned to TOT						230,000		
Plus Unexpended Budget							195,000	
Unused/(Excess) Allocation	\$ 0	\$ 176,958	\$ 78,277	\$ 358,680	\$ <244,742>	\$ 34,391	\$ 117,574	\$ <142,356>
Special Appropriation for Roof Repairs				<200,000>				
Transfer from General Fund						262,000		
Net Unused/(Excess) Allocations	\$ 0	\$ 288,260	\$ 131,810	\$ 300,665	\$ <201,119>	\$ <159,349>	\$ 102,358	\$ <320,000>

* Assumes Continuation of 1986-87 Funding Level

TABLE II
TRANSIENT OCCUPANCY TAX
COMPARISON OF ORDINANCE PRESCRIBED TO
ACTUAL REVENUE ALLOCATIONS
1980-81 THROUGH 1987-88

	Base Year 1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	Estimated 1986-87	Estimated 1987-88
Cumulative Balance, Unused/ (Excess) Allocations	\$ 0	\$ 288,260*	\$ 420,070*	\$ 720,735**	\$ 519,616*	\$ 622,267*	\$ 822,125	\$ 502,125
Loan from General Fund to Cultural Groups							\$ 97,500	\$ 97,500
Unallocated from General Fund						\$ 262,000	262,000	262,000
Convention and Visitors Bureau	\$ 0	\$ 55,121	\$ 60,571	\$ 145,370	\$ 185,625	92,525	154,450	86,411
Cultural Groups	0	56,181	104,264	161,450	164,818	64,178	<12,963>	<122,568>
Convention and Cultural Facilities	0	176,958	255,235	413,915	169,173	203,564	321,138	178,782
TOTAL	\$ 0	\$ 288,260	\$ 420,070	\$ 720,735	\$ 519,616	\$ 622,267	\$ 822,125	\$ 502,125

* Per Audit Financial Statements

** Audit Financial Statements recognize the \$278,000 investment loss in 1983-84. For purposes of this exercise the loss was applied against 1984-85 revenue allocations.